

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

APPLICATION OF YORKTOWN SEWAGE)
TREATMENT FACILITIES, INC., FOR)
AN ADJUSTMENT OF RATES PURSUANT) CASE NO. 8759
TO THE ALTERNATIVE PROCEDURE FOR)
SMALL UTILITIES)

O R D E R

On January 20, 1983, Yorktown Sewage Treatment Facilities, Inc., ("Yorktown") filed an application with the Commission to increase its sewer rates pursuant to 807 KAR 5:076. This regulation allows utilities with 400 or fewer customers or \$200,000 or less gross annual revenues to use the alternative rate filing method ("ARF") in order to minimize the necessity for formal hearings, to reduce filing requirements and to shorten the time between the application and the Commission's final Order. This procedure minimizes rate case expenses to the utility and, therefore, results in lower rates to the ratepayers.

Yorktown requested rates which would produce an annual increase of \$51,816. According to Yorktown's application, the present revenues are insufficient to meet its operating expenses and make the necessary repairs and improvements to the sewer system. In this Order the Commission has allowed rates to produce an increase of \$15,893.

There were no intervenors in this matter, and all information requested by the Commission has been submitted.

TEST PERIOD

For the purpose of determining the reasonableness of the proposed rates, the 12-month period ending December 31, 1981, has been accepted as the test period.

REVENUES AND EXPENSES

Yorktown proposed no specific adjustments to test period operations with the exception of pro forma information furnished in its responses to the Commission's request for additional information. The Commission advises Yorktown that prior to filing future rate cases, it should familiarize itself with the Commission's policy concerning pro forma adjustments, and its filing and records should adhere to the Uniform System of Accounts for Sewer Utilities as prescribed by this Commission.

In accordance with the Commission's rate-making policies, the following adjustments have been made to Yorktown's test period operations to reflect current operating conditions more accurately:

Operating Revenues and Purchased Water Expense

Yorktown submitted a letter dated February 25, 1983, from the Louisville Water Company ("LWC") which showed monthly water expense for the test period totalling \$2,501. Yorktown advised the Commission that the LWC deducted the water bill from the sewer revenue remittance each month of the test year with the exception of \$593. Yorktown recorded its revenue at the net amount

incorrectly, and the Commission is of the opinion that proper accounting requires that gross revenues and water expense each should be increased by \$1,908.

Purchased Power Expense

Yorktown submitted a letter dated March 3, 1983, from the Louisville Gas and Electric Company ("LG&E") showing total test period electric expense of \$8,289 compared to Yorktown's recorded cost on its operating statement of \$8,002. The Commission is therefore of the opinion that purchased power expense should be increased by \$287. Moreover, the Commission also finds it appropriate to increase this operating expense by \$622, which represents the 7.5 percent increase granted LG&E in its last rate case, Case No. 8616, subsequent to the test period in this case.

Chemicals

Yorktown's recorded chemical expense for the test period was \$101. The Commission has transferred \$431 to this account because an invoice for liquid chlorine purchased from Ulrick Chemicals, Inc., was erroneously charged to maintenance of the pumping system. Yorktown's purchase of chemicals included a \$300 drum deposit. Drum deposits are refundable and are not considered an operating expense. Therefore, the Commission has denied this portion of adjusted test period chemical expense by \$300. Moreover, because of Yorktown's cash flow problems, chemical purchases of \$709 were made from the Louisville Chemical Company at various times during the test period and paid for by Yorktown Apartments. These chemicals were used but not charged to test

period operations by Yorktown. The Commission has further adjusted chemicals by \$709.

Routine Maintenance Service Fee

Yorktown's recorded expense for routine maintenance service fees during the test period was \$2,952. In its review of Yorktown's test period operations, the Commission found that numerous expenditures were improperly recorded in various accounts. Routine maintenance service fees should be increased by \$4,730 to include fees improperly recorded in maintenance of pumping systems; should be reduced by \$189 and \$875 for expenses that should properly be recorded in maintenance of pumping systems and outside services, respectively; and should be reduced by \$808 for non-recurring rate case expenses improperly included. Finally, the Commission has reduced the adjusted test period expense of \$5,810 in this account by \$1,310 to reflect the annual effect of the current monthly routine maintenance service fee of \$375 charged Yorktown by Jack Wolford Enterprises, Inc.

Maintenance of Pumping System

Yorktown's recorded expense for maintenance of the pumping system for the test period was \$10,205. As previously discussed, \$4,730 and \$431 for routine maintenance service fees and chemicals, respectively, were erroneously charged to this account and \$189 was erroneously charged as routine maintenance service fees instead of to this account. These amounts have been charged to the correct accounts. A further analysis of the expenditures in this account revealed that \$244 should be charged to sludge

hauling expense and the Commission has transferred this expense accordingly.

During the test period Yorktown also made certain improvements to its plant and purchased items of equipment that extended the life of its system. These expenditures were charged to this account but should properly be capitalized to the plant accounts and depreciated over the period of benefit to the ratepayers. Therefore, the Commission has reduced maintenance of the pumping system expenses by the following capital items:

<u>Date</u>	<u>Description</u>	<u>Amount</u>
8/24/81	Drive shaft assembly for lift pump	\$ 299
4/22/81	Repair to lift pump assembly	1,078
9/24/81	Alarm system and time clock on blower	284
5/22/81	Installation of sump pump, motor and shaft	<u>414</u>
		\$2,075

Yorktown also rented a pump from Culver Clark Construction Company for \$650. Since this is a nonrecurring item of expense, the Commission has decreased maintenance of the pumping systems expense by this amount.

The total of the above adjustments results in adjusted test period maintenance of the pumping system expenses of \$2,264.

Agency Collection Fee

Yorktown projected expenses for the collection of its bi-monthly sewer bill by the LWC of \$604. The Commission has made an adjustment of \$931 to increase this expense to reflect the apportionment of the joint service cost of the collection agency

for each bi-monthly bill which reflects the charge for water and the increase in the sewer service bill allowed herein.

Depreciation Expense

Yorktown recorded depreciation expense for the test period of \$4,813. The Commission has increased test period depreciation expense by \$692¹ to allow depreciation on capital items excluded from maintenance of the pumping system expenses as described above. This adjustment reflects an expected useful life of 3 years.

The Commission has also reduced depreciation expense in accordance with its policy that depreciation should be computed on the basis of original cost of the plant in service less contributions in aid of construction. The Commission is of the opinion that it is unfair to require ratepayers to provide recovery on that portion of plant provided free of cost. Therefore, the Commission finds that depreciation expense should be reduced for rate-making purposes by \$4,389.²

Thus the Commission finds that the appropriate adjusted test period depreciation expense is \$1,116.

¹ $\$2,076 \div 3 = \$692.$

² Calculation:

Gross plant in service at 12/31/81	\$216,814
Less: Contributions in aid of construction	<u>197,691</u>
Net depreciable plant in service	\$ 19,123
X Composite depreciation rate	<u>2.22%</u>
Allowable depreciation expense	\$ 424
Depreciation expense per books	<u>4,813</u>
Adjustment	<u>\$ (4,389)</u>

Rate Case Expense

Yorktown has estimated its expenses for this rate case to be \$4,507 and has proposed to amortize the amount over a 3-year period for rate-making purposes. Upon request, the Commission was furnished an itemized statement of the time spent in the preparation of the rate application by Yorktown's attorneys. The Commission is of the opinion that the preparation time is excessive for a utility the size of Yorktown under the ARF procedure, which was developed and implemented by the Commission to reduce the level of professional assistance required in the preparation of rate cases. It is the Commission's opinion and policy in this and future ARF cases that if rate case expenses exceed \$1,000, the burden of proof is on the applicant to show that such fees were required because of unusual circumstances. If the unusual circumstances involve poor records, then the level of on-going accounting and management expenses will be considered in determining the reasonableness of the rate case expenses. If it is determined that the fees are high because of management preferences, then the fees may be disallowed or divided between management and ratepayers.

The Commission has considered Yorktown's ARF application and the evidence of record and finds no unusual circumstance to warrant the fees for rate case preparation and has, therefore, concluded that \$1,000 of rate case expenses amortized over a 3-year period is the fair, just and reasonable amount to be paid by the ratepayers. The remaining cost should be considered an

expense of Yorktown. Thus, the Commission has allowed total rate case expenses of \$333 in the adjusted rates.

Management Fee

As stated, the Commission requested and received from Yorktown's attorneys a complete analysis of time devoted to the legal affairs of Yorktown. After a thorough review of this document, the Commission is of the opinion that the legal firm not only prepared the rate application, as discussed above, but also performed other routine management duties during the test period for the benefit of its client, Yorktown. There were no management fees paid during the test period nor included in test period expenses. Therefore, in this instance, the Commission has allowed a pro forma management fee of \$1,800 per year which it considers to be reasonable compensation for management duties for Yorktown based on fees paid for this service by similarly-sized utilities operating under the jurisdiction of the Commission.

Interest Expense

Yorktown had actual interest expense of \$34 at the end of the test period. Yorktown informed the Commission that major repairs and improvements amounting to approximately \$13,550, based on an estimate from Jack Wolford Enterprises, Inc., were needed for the purpose of complying with the regulations of the Jefferson County Health Department as noted in its letter of December 7, 1982. Also, the Commission's engineering staff made an on-site inspection of the sewer system and concurred with the Jefferson County Health Department that the repairs and improvements were necessary.

The Commission recognizes that Yorktown will be required to borrow the funds for the needed repairs through a bank or other lending institution. Counsel for Yorktown contacted the Stockyards Bank in Louisville, Kentucky, concerning a loan of \$15,000 and submitted a letter stating that if the loan were approved, the terms would be for 3 years at either a 16 percent fixed interest rate or the prime rate plus a 2 percent variable interest rate.

It is the Commission's policy not to grant pro forma adjustments which are neither known nor measurable. Therefore, the Commission must deny this proposed interest expense at this time. In the event that Yorktown is able to obtain commitments regarding the rate of interest for the financing required to complete these major repairs and improvements and submit proof thereof within 20 days of the date of this Order, the Commission will be receptive to a rehearing on this matter.

Therefore, Yorktown's adjusted operations at the end of the test period are as follows:

	<u>Per Books</u>	<u>Adjustments</u>	<u>Adjusted</u>
Operating Revenues	\$ 16,058	\$ 1,908	\$ 17,966
Operating Expenses	<u>30,982</u>	<u>(2,250)</u>	<u>28,732</u>
Net Operating Income	<u>\$(14,924)</u>	<u>\$ 4,158</u>	<u>\$(10,766)</u>
Interest Expense	<u>34</u>	<u>-0-</u>	<u>34</u>
Net Income	<u>\$(14,958)</u>	<u>\$ 4,158</u>	<u>\$(10,800)</u>

REVENUE REQUIREMENTS

The Commission is of the opinion that Yorktown's adjusted operating loss is unfair, unjust and unreasonable. The Commission

is further of the opinion that an operating ratio of 88 percent is fair, just and reasonable in that it will allow Yorktown to meet its operating expenses, service its debt and provide a reasonable return to its stockholders. Therefore, the Commission finds that Yorktown should be permitted to increase its rates to produce an increase in annual revenue of \$15,893,³ which includes federal, state and Jefferson County income taxes of \$1,034.

SUMMARY

The Commission, after consideration of the evidence of record and being advised, is of the opinion and finds that:

1. The rates proposed by Yorktown would produce revenues in excess of the revenues found reasonable herein and should be denied upon application of KRS 278.030.

2. The rates in Appendix A are the fair, just and reasonable rates to charge for sewer service rendered to Yorktown's customers and should produce annual revenues of approximately \$33,859.

3. Yorktown has on file with this Commission a valid third-party beneficiary agreement.

4. Especially in the area of operating expenses, Yorktown has not maintained its accounting records pursuant to KRS 278.220 which requires that each utility shall set up the proper accounts to conform with the Commission's Uniform System of Accounts for Sewer Utilities.

³ $\$28,732 + \$1,034 = \$29,766 + 88 \text{ percent} = \$33,825 + \$34 - \$17,966 = \$15,893.$

IT IS THEREFORE ORDERED that the rates in Appendix A be and they hereby are fixed as the fair, just and reasonable rates of Yorktown to become effective for sewer service rendered on and after the date of this Order.


IT IS FURTHER ORDERED that the rates proposed by Yorktown be and they hereby are denied.

IT IS FURTHER ORDERED that Yorktown shall maintain its accounting records in accordance with the Uniform System of Accounts for Sewer Utilities.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Yorktown shall file with this Commisison its tariff sheets setting forth the rates approved herein and a copy of its rules and regulations for providing sewer service.

Done at Frankfort, Kentucky, this 8th day of September, 1983.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:

Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC
SERVICE COMMISSION IN CASE NO. 8759 DATED
SEPTEMBER 8, 1983

The following rates are prescribed for all customers served by Yorktown Sewage Treatment Facilities, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect prior to the date of this Order.

CLASSIFICATION:

MONTHLY RATE

Apartments	\$ 3.70
Residential	5.50
Small Commercial	11.75